

DODD-FRANK’S SPECIALIZED DISCLOSURE PROVISIONS 1502 AND 1504: SMALL BUSINESS, BIG IMPACT

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I. INTRODUCTION

In response to the worst economic meltdown since the Great Depression, in 2010, Congress enacted the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act). The purpose of the Act is to “promote the financial stability of the United States by improving accountability and transparency in the financial system, to end ‘too big to fail’, to protect the American taxpayer by ending bailouts, to protect consumers from abusive financial services practices, and for other purposes.”¹ Dodd-Frank sections 1502, 1503 and 1504 focus on some of these “other purposes.” These specialized disclosure provisions, relating to conflict minerals, mine safety and resource extraction, respectively, are particularly controversial for their social and humanitarian, rather than financial, basis. Conflict minerals (section 1502) and resource extraction (section 1504) disclosures have proven especially controversial. Hidden within the 2300-page Act, these two sections are “aimed not at preventing another financial meltdown but, rather, at fostering transparency about commercial activities in foreign countries.”²

This Note will focus on the effects of the conflict minerals and resource extraction provisions on businesses, particularly the effects on small businesses. Part II begins with a short introduction to the Dodd-Frank Act and the Securities and Exchange Commission’s (SEC or Commission) role in relation to the Act overall as well as the specific disclosure provisions. It then gives background on each provision, detailing the purpose and requirements of the provisions, as well as the recent legal challenges to each. Part III explores the wide-reaching scope of the provisions and the costs and benefits of the provisions—financial, social and otherwise. In Part IV, this Note discusses how, while the benefits of the provisions may (or may not) fit the humanitarian goals, the benefits are

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¹ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 1376 (2010) (codified in scattered titles of the U.S.C.).

² Laura E. Seay, *What’s Wrong with Dodd-Frank 1502? Conflict Minerals, Civilian Livelihoods, and the Unintended Consequences of Western Advocacy* 3 (Ctr. for Global Dev., Working Paper No. 284, 2012).

intangible and outweighed by the severe monetary costs and competitive disadvantage to affected businesses. Moreover, the far-reaching scope, which provides no exclusions for small businesses, harms small businesses to a degree that makes these provisions irresponsible, particularly considering the financial nature and purpose of the Dodd-Frank Act. This Note then proposes several solutions. Firstly, Congress should re-examine these provisions in light of the reasonable concerns expressed by many businesses and the SEC, and due to the discrepancy between the humanitarian motivations behind these provisions and the goals of Dodd-Frank. Alternately, this note proposes that the SEC use its rulemaking powers to re-interpret the language of these provisions in a way that accurately encompasses the commentators' worries. Finally, this Note encourages businesses to continue to pursue thoughtful challenges to the provisions.

II. BACKGROUND

A. *A Brief Overview of Dodd-Frank and the SEC*

The financial meltdown was attributable to a number of factors, though these factors differ based on whom you ask. Some narratives point to government intervention in the housing market as the primary cause.³ Others point to greedy Wall Street bankers, who manipulated the financial system and the politicians in Washington in order to enjoy large personal gains at the expense of homeowners.⁴ The latter is the primary view of the Financial Crisis Inquiry Commission, the commission created by Congress to investigate the causes of the financial crisis.⁵ Of course, the causes are more complicated than either of these narratives seems to suggest.

During its investigation, the Financial Crisis Inquiry Commission found that the particular mix of circumstances that led to the meltdown began in the early 2000s, when the Federal Reserve cut interest rates and mortgage rates fell, resulting in a surge of home refinancing.⁶ Home sales increased and housing values skyrocketed, leading many people to buy and sell homes under the belief that housing prices would always remain high.⁷ Homeowners took out home equity loans to pay for children's college, medical and credit card bills, as well as to update their homes, go on

³ Bill Thomas et al., *What Caused the Financial Crisis?*, WALL ST. J. (Jan. 27, 2011, 12:01 AM), <http://online.wsj.com/news/articles/SB10001424052748704698004576104500524998280>.

⁴ *Id.*

⁵ *Id.*

⁶ FIN. CRISIS INQUIRY COMM'N, THE FINANCIAL CRISIS INQUIRY REPORT 5 (2011).

⁷ *Id.*

vacation and start new businesses.⁸ In an attempt to participate in the booming economy, many borrowers agreed to take part in risky nontraditional loan schemes in order to be able to live beyond their means.⁹

These nontraditional loans were offered by Wall Street, which labored to provide loans to meet the growing demand.¹⁰ Financiers gave out loans to “subprime” borrowers with poor credit histories who lacked the ability to repay them.¹¹ These “subprime” loans were then pooled together to create allegedly low risk securities, which made them at least appear “safer.”¹² These pooled mortgages were then used to back securities called “collateralised debt obligations (CDOs), which were sliced into tranches by degree of exposure to default.”¹³ The securities were then incorrectly categorized as safe investments by credit reporting agencies—a decision that went unquestioned.¹⁴

This situation culminated in the housing bubble, which inevitably burst, exposing the facade that was the U.S. financial system.¹⁵ By this time, most large U.S. investment banks were deeply in debt and heavily dependent on short-term loans to conduct their day-to-day business.¹⁶ As the borrowers of “subprime” mortgages failed to pay in greater and greater numbers, Bear Stearns and Lehman Brothers’ creditors became fearful, due to their heavy involvement in these subprime mortgages, and refused to renew their short-term loans.¹⁷ Large institutional customers of Bear Stearns and Lehman Brothers then “panicked and yanked their money out of . . . both firms, triggering a 21st century version of a run.”¹⁸ The two investment banks’ liquid assets disappeared within days and they were unable to pay back their short-term loans, which then jeopardized other big firms, among them Morgan Stanley and Goldman Sachs.¹⁹ Lehman Brothers was forced into bankruptcy, which threw the global financial market into chaos.²⁰ This situation began the worst financial crisis since the Great Depression.²¹

⁸ *Id.*

⁹ *Id.* at 7.

¹⁰ *Id.* at 6.

¹¹ *The Origins of the Financial Crisis: Crash Course*, ECONOMIST (Sept. 7, 2013), <http://www.economist.com/news/schoolsbrief/21584534-effects-financial-crisis-are-still-being-felt-five-years-article>.

¹² *Id.*

¹³ *Id.*

¹⁴ Thomas et al., *supra* note 3.

¹⁵ *The Origins of the Financial Crisis: Crash Course*, *supra* note 11.

¹⁶ BANKING LAW MANUAL § 4.07 (2014).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ See DAVID SKEEL, *THE NEW FINANCIAL DEAL: UNDERSTANDING THE DODD-FRANK ACT AND ITS (UNINTENDED) CONSEQUENCES* 2 (2010).

Congress enacted Dodd-Frank to address this situation. Dodd-Frank creates a multitude of new laws as well as a new federal agency, the Bureau of Consumer Financial Protection, and concentrates these reforms mainly on large banks and nonbank financial institutions, which present the greatest possibility of “systemic economic risk.”²² The new regulations can be divided into two categories of objectives: those that “limit the risk of contemporary finance” and those that “limit the damage caused by the failure of a large financial institution.”²³

Pursuant to its goals of transparency and protection of consumers and investors, Dodd-Frank appoints the SEC as the regulatory agency to implement ninety provisions in the Act, including the disclosure provisions set forth in sections 1502 and 1504.²⁴ This is in conjunction with the SEC’s role of protecting investors, maintaining fair, orderly, and efficient markets, and facilitating capital formation.²⁵ The SEC accomplishes these goals mainly through public disclosure requirements, which are intended as a means to protect investors.²⁶ Thus, “the SEC typically only requires the disclosure of financial information that would assist an investor in the valuation of a security.”²⁷

Mary Jo White, Chair of the SEC, has said that while the agency must respect Congress and write the rules it is required to write, she questions whether federal securities law is the proper vehicle to pursue social changes or end human rights abuses, the topics addressed in sections 1502 and 1504.²⁸ According to White, these socially motivated rules “seem more directed at exerting societal pressure on companies’ rather than helping investors make informed decision.”²⁹ Likewise, former SEC Commissioner Troy Parades expressed that the 1502 rulemaking proved to be especially difficult due to the fact the Commission “has no expertise when it comes to

²² Cheryl D. Block, *A Continuum Approach to Systemic Risk and Too-big-to-fail*, 6 BROOKLYN J. CORP. FIN. & COM. L. 289, 292–93 (2012).

²³ SKEEL, *supra* note 21, at 4.

²⁴ *Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act*, SEC (Mar. 14, 2014), <http://www.sec.gov/spotlight/dodd-frank.shtml>.

²⁵ *The Investor’s Advocate: How the SEC Protects Investors, Maintains Market Integrity, and Facilitates Capital Formation*, SEC, <http://www.sec.gov/about/whatwedo.shtml> (last modified June 10, 2013).

²⁶ Emily Veale, Note, *Is There Blood on Your Hands-free Device?: Examining Legislative Approaches to the Conflict Minerals Problem in the Democratic Republic of Congo*, 21 CARDOZO J. INT’L & COMP. L. 503, 527 (2013).

²⁷ *Id.* at 528 (citing Cynthia A. Williams, *The Securities and Exchange Commission and Corporate Social Transparency*, 112 HARV. L. REV. 1197, 1208 (1999)).

²⁸ Aruna Viswanatha & Sarah N. Lynch, *SEC Chair Chastises Congress over New Disclosure Rules*, REUTERS (Oct. 3, 2013, 9:23 PM), <http://www.reuters.com/article/2013/10/03/us-sec-disclosures-idUSBRE99215Q20131003>.

²⁹ Sarah N. Lynch, *SEC’s Gallagher Slams Effort to Adopt Political Disclosure Rules*, REUTERS (Oct. 25, 2013, 12:19 PM), <http://www.reuters.com/article/2013/10/25/sec-gallagher-disclosure-idUSL1N0IF0SN20131025>.

the humanitarian goal of ending the atrocities that besiege the DRC [Democratic Republic of Congo],” nor the expertise to regulate supply chain management.³⁰ With regard to 1504, SEC Commissioner Daniel M. Gallagher expressed his concern that “[t]his rule will be a very indirect route to achieving any sort of global governmental accountability.”³¹ Of the SEC involvement, he added, “I do not think the SEC has any realistic prospect of achieving the desired result, although I am fully convinced that we will impose significant costs on issuers — and thereby shareholders — in the process.”³² Nevertheless, the Commission promulgated rules for both provisions as mandated by Congress.

B. *An Overview: Section 1502 Conflict Mineral Disclosures*

1. *Purpose and Background of Section 1502*

Section 1502 arose out of several earlier bills that died in committee, including the Conflict Coltan and Cassiterite Act of 2008, the Congo Conflict Minerals Act of 2009 and most recently the Conflict Minerals Trade Act (H.R. 4128).³³ The purpose of H.R. 4128 was to “help stop the deadly conflict over minerals in eastern Congo by regulating the importation and trade of tin, tungsten and tantalum — minerals commonly used in cell phones, laptop computers and other popular electronic devices.”³⁴ However, the resolution never moved out of committee.³⁵ Then, in July 2010, provisions focusing on DRC conflict minerals were attached on the final night of deliberations by a House-Senate conference committee to the Dodd-Frank Wall Street Reform and Consumer Protection Act.³⁶ This became section 1502, which passed into law with the rest of the Act.³⁷

Congress enacted section 1502 operating under the belief that “the exploitation and trade of conflict minerals originating in the Democratic Republic of the Congo is helping to finance conflict characterized by extreme levels of violence in the eastern Democratic Republic of the Congo, particularly sexual- and gender-based violence, and contributing to

³⁰ Troy A. Paredes, Comm’r, Sec. & Exch. Comm’n, Statement at Open Meeting to Adopt a Final Rule Regarding Conflict Minerals Pursuant to Section 1502 of the Dodd-Frank Act (Aug. 22, 2012).

³¹ Daniel M. Gallagher, Comm’r, Sec. & Exch. Comm’n, Statement at SEC Open Meeting: Proposed Rules to Implement Section 1504 of the Dodd-Frank Act (“Disclosure of Payments by Resource Extraction Issuers”) (Aug. 22, 2012).

³² *Id.*

³³ Karen E. Woody, *Conflict Minerals Legislation: The SEC’s New Role as Diplomatic and Humanitarian Watchdog*, 81 *FORDHAM L. REV.* 1315, 1325 (2012).

³⁴ Seay, *supra* note 2, at 10.

³⁵ *Id.*

³⁶ Seay, *supra* note 2; Letter from Gary G. Miller et al. to Mary Schapiro, Chairman, Sec. & Exch. Comm’n (Aug. 10, 2012).

³⁷ Seay, *supra* note 2.

an emergency humanitarian situation therein.”³⁸ Congress was compelled to act based on the horrific violence perpetrated by Rwandan extremists in the DRC, violence funded through the illicit sale of minerals.³⁹ According to the bill’s sponsor, many researchers have found that “when the price of black market natural resources in the DRC goes down, the rate of violence drops with it.”⁴⁰ Congress thought that by “requiring companies ‘to make public and disclose annually to the Securities and Exchange Commission if the minerals in their products originated or may have originated in Congo’ will help ‘to ensure activities involving such minerals did not finance or benefit armed groups.’”⁴¹ Congress believed that the disclosure would help ensure that the minerals would not finance or benefit an armed group by encouraging the companies that used such minerals to find new, responsible sources.⁴²

Whether this purpose can be accomplished with this legislation is open to debate. The Information Technology Industry Council, a fervent advocate for improved transparency and accountability in relation to Congolese minerals, believes that “the solution to Congo’s problems will not come from the private sector[,]” but rather through the “steadfast and coordinated engagement of global governments.”⁴³ By contrast, many other humanitarian organizations expressed in their letters to the SEC support of the measures, believing that there is a fit between due diligence in the supply chain and humanitarian aid, or at least that the situation in the DRC is dire enough that the United States should do something to help.⁴⁴

2. *Requirements of Section 1502*

The Act directs the SEC to promulgate regulations requiring companies that use “conflict minerals” that are “necessary to the

³⁸ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1502(a), 124 Stat. 1376, 2213 (2010) (codified in scattered titles of the U.S.C.).

³⁹ Letter from Richard J. Durbin, U.S. Senator, & Jim McDermott, U.S. Congressman, to Mary L. Schapiro, Chairman, Sec. & Exch. Comm’n (Oct. 4, 2010).

⁴⁰ *Id.*

⁴¹ Nat’l Ass’n of Mfrs. v. SEC, 956 F. Supp. 2d 43, 46 (D.D.C. 2013) (citing 156 CONG. REC. S3976 (May 19, 2010) (statement of Sen. Feingold)). The D.C. Circuit Court recently overturned the 1st Amendment claim in Nat’l Ass’n of Mfrs. v. SEC, 2014 WL 1408274 (D.C.C. Apr. 14, 2014).

⁴² Nat’l Ass’n of Mfrs., 956 F. Supp. 2d at 46 (D.D.C. 2013) (citing 156 CONG. REC. S3817 (May 17, 2010) (statement of Sen. Durbin)).

⁴³ Seay, *supra* note 2, at 12.

⁴⁴ See Letter from Corinna Gilfillan, Head of Global Witness U.S. Off. to Mary L. Schapiro, Chairman, Sec. & Exch. Comm’n (Oct. 12, 2010); see also Letter from Wynnette LaBrosse, President of Open Square Foundation to Mary L. Schapiro, Chairman, Sec. & Exch. Comm’n (Nov. 30, 2010); Letter from Laura Matter, A Thousand Sisters & Outcry for Congo to Meredith Cross, Director, Div. of Corp. Fin., Sec. & Exch. Comm’n (Dec. 15, 2010).

functionality or production” of their products to disclose to the Commission whether those minerals originated in the DRC or an adjacent country.⁴⁵ “Conflict minerals” is defined by the Act as “columbite-tantalite (coltan), cassiterite, gold, wolframite, or their derivatives,” along with any other mineral or derivative that the Secretary of State determines is “financing conflict” in the DRC.⁴⁶ These conflict minerals can be found in many types of products such as electric circuits (cassiterite); electrical components in cell phones, computers, aircrafts, surgical equipment, etc. (columbite-tantalite); jewelry, electronic, aerospace equipment (gold); metal wires and electrodes involved in electrical, heating and welding applications (wolframite).⁴⁷

If a company does have these conflict minerals in its supply chain, then it must submit an additional report to the SEC that contains: 1) a description of the measures taken “to exercise due diligence on the source and chain of custody of such minerals” and 2) “a description of the products manufactured or contracted to be manufactured that are not DRC free” as well as “facilities used to process the conflict minerals, the country of origin of the conflict minerals, and the efforts to determine the mine or location of origin with the greatest possible specificity.”⁴⁸ Moreover, the company must make “available to the public on the Internet website of such person the information disclosed.”⁴⁹

The final SEC rule, the final form of the regulations the SEC made as required by the Act, gives three steps for determining coverage of the provision: 1) an issuer needs to determine whether its manufactured products contain conflict minerals that subject it to the requirements of Dodd-Frank section 1502; 2) an issuer needs to determine whether its necessary conflict minerals originated in the covered countries; 3) an issuer with necessary conflict minerals from covered countries that are not from recycled or scrap sources needs to conduct due diligence and potentially provide a Conflict Minerals Report.⁵⁰ Covered countries include the DRC and adjoining countries.⁵¹

⁴⁵ 15 U.S.C. §§ 78m(p)(1)(A), 78m(p)(2)(B) (2012). The D.C. Circuit Court recently declared parts of 15 U.S.C. § 78m unconstitutional in *Nat'l Ass'n of Mfrs.* 2014 WL 1408274.

⁴⁶ Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1502(e)(4), 124 Stat. 1376, 2218 (2010) (codified in scattered titles of the U.S.C.).

⁴⁷ ERNST & YOUNG, CONFLICT MINERALS: WHAT YOU NEED TO KNOW ABOUT THE NEW DISCLOSURE AND REPORTING REQUIREMENTS AND HOW ERNST & YOUNG CAN HELP 2 (2012).

⁴⁸ 15 U.S.C. § 78m(p)(1)(A)(i)–(ii).

⁴⁹ *Id.* § 78m(p)(1)(E).

⁵⁰ ERNST & YOUNG, *supra* note 47.

⁵¹ Conflict Minerals, 77 Fed. Reg. 56,274, 56,275 (Sept. 12, 2012) (to be codified at 17 C.F.R. pts. 240, 249b). The D.C. Circuit Court recently overturned the

The final rule requires an issuer that determines that its conflict minerals did not originate in the covered countries, or that they did come from recycled or scrap sources, to disclose that determination in its specialized disclosure report.⁵² In its specialized disclosure report the issuer must then briefly describe the reasonable country of origin inquiry it used in reaching the determination and the results of the inquiry.⁵³ Additionally, the issuer must disclose this information on its publicly available website under a separate heading in its specialized disclosure report entitled “Conflict Minerals Disclosure” and provide a link to that website.⁵⁴

If the issuer determines that its conflict minerals did originate in the covered countries, and that they are not from recycled or scrap sources, it is required to file a Conflict Minerals Report as an exhibit to its specialized disclosure report and to provide the report on its publicly available internet website.⁵⁵ The issuer must also disclose “[u]nder a separate heading in its specialized disclosure report entitled ‘Conflict Minerals Disclosure’ . . . that it has filed a Conflict Minerals Report and provide the link to its Internet Web site where the Conflict Minerals Report is publicly available.”⁵⁶

Furthermore, the final form of the rule “requires an issuer to provide the conflict minerals disclosures that would have been in the body of the annual report in the body of a new specialized disclosure report on a new form, Form SD.”⁵⁷ Thus, issuers required to provide a Conflict Minerals Report must do so as an exhibit.⁵⁸

The final version of the rule applies to “any issuer that files reports with the Commission under Section 13(a) or Section 15(d) of the Exchange Act, including domestic companies, foreign private issuers, and smaller reporting companies.”⁵⁹ The final rule allows for a transition period of two years for all issuers and four years for smaller reporting companies.⁶⁰ A smaller reporting company is defined as “a company with less than \$75 million of public equity float or revenues less than \$50 million, if float cannot be calculated.”⁶¹ During this period, issuers may describe their products as “DRC conflict undeterminable” if they are not able to meet the

constitutionality of requiring conflict minerals disclosure in *Nat’l Ass’n of Mfrs. v. SEC*, 2014 WL 1408274 (D.C.C. Apr. 14, 2014).

⁵² 77 Fed. Reg. at 56,277.

⁵³ *Id.*

⁵⁴ *Id.*

⁵⁵ *Id.*

⁵⁶ *Id.* at 56,363.

⁵⁷ *Id.* at 56,280.

⁵⁸ *Id.*

⁵⁹ *Id.* at 56,287.

⁶⁰ *Id.* at 56,281.

⁶¹ *Conflict Minerals: Frequently Asked Questions*, PRICEWATERHOUSECOOPERS LLP, <http://www.pwc.com/us/en/audit-assurance-services/conflict-minerals-faqs.jhtml> (last visited Feb. 22, 2014).

“DRC conflict free definition,” meaning that after due diligence, they are unable to determine if their conflict minerals financed or benefited armed groups in the covered countries or whether the conflict minerals came from recycled or scrap sources.⁶² Additionally, the rule exempts any conflict minerals that are outside the supply chain prior to January 31, 2013.⁶³ Minerals are considered outside the supply chain when they have been smelted or fully refined into their final state of metal or did not originate in the covered countries.⁶⁴

3. National Association of Manufacturers v. SEC

The SEC’s rulemaking was challenged in federal court by the National Association of Manufacturers (NAM), the Chamber of Commerce and the Business Roundtable.⁶⁵ Plaintiffs challenged the rule as arbitrary and capricious under the Administrative Procedure Act (APA) and claimed that the rule improperly compels speech in violation of the First Amendment.⁶⁶ The District Court ruled on summary judgment motions based on these claims, finding in favor of the SEC.⁶⁷

Plaintiffs alleged that “the SEC improperly deferred to Congress’s determination that conflict minerals disclosures would decrease violence in the DRC,” and that it neglected to conduct its own “independent analysis of the social benefits of the rule, and arbitrarily underestimated aspects of the Rule’s costs.”⁶⁸ Because of this, “Plaintiffs contended that the SEC violated Exchange Act Sections 3(f) and 23(a)(2) by failing to consider whether the Rule would ‘promote efficiency, competition, and capital formation’ and would not ‘impose a burden on competition not necessary or appropriate in furtherance of the purposes of’ the Exchange Act.”⁶⁹ The district court, however, did not believe that it was clear that the requirements in Exchange Act sections 3(f) and 23(a)(2) applied in the first place, “since they were not expressly referenced in Section 1502 of Dodd-Frank, and Congress had already concluded the disclosure requirements were necessary and in the public interest.”⁷⁰ Furthermore, the court states that those Exchange Act sections do not mandate the type of detailed analysis that the Plaintiffs advocate, but rather direct the SEC to consider the impact on various

⁶² 77 Fed. Reg. at 56,310.

⁶³ *Id.*

⁶⁴ ERNST & YOUNG, *supra* note 47, at 1.

⁶⁵ Nat’l Ass’n of Mfrs. v. SEC, 956 F. Supp. 2d 43, 46 (D.D.C. 2013).

⁶⁶ *Id.*

⁶⁷ *DC District Court Upholds SEC’s Conflict Mineral Due Diligence and Reporting Rule*, STEPTOE & JOHNSON LLP (Aug. 9, 2013) [hereinafter STEPTOE], <http://www.steptoel.com/publications-8990.html>.

⁶⁸ *Id.*

⁶⁹ *Id.*

⁷⁰ *Id.*

economic factors.⁷¹

With respect to the Plaintiffs' claim that the SEC improperly deferred to Congress on the issue of cost, the court determined that the SEC weighed comments from many parties and carefully selected the figures that it, in its discretion, felt were most appropriate.⁷² The court stated that while Plaintiffs "may disagree, the Court cannot say that the SEC acted arbitrarily or capriciously" in reaching its determinations with regard to cost.⁷³ The court also denied the Plaintiffs' APA claims, finding that "the Commission's choice not to include a *de minimis* exception in the Final Rule was the product of reasoned decision-making."⁷⁴ The court believed that the SEC's decision was not compelled by Congress, as Plaintiffs claimed, but rather that the record demonstrated that the SEC exercised its discretion in interpreting its mandate.⁷⁵ Thus, because the statute was silent, the court believed that the Commission was entitled to deference in its determination that a *de minimis* exception would jeopardize the effectiveness of the rule.⁷⁶

Additionally, the court denied the First Amendment claim finding a reasonable fit between the relevant provisions of section 1502, the Final Rule and Congress's objectives in promoting peace and security in and around the DRC, thus satisfying the scrutiny standard for the case.⁷⁷ The court focused on the constitutionality of requiring companies to post conflict minerals disclosures on their own public websites.⁷⁸ Because Plaintiffs conceded that the "government has a substantial if not compelling interest in the promotion of peace and security in the covered countries," the court focused on whether the SEC was required to prove a stronger relationship between the rule and Congress's interest in promoting peace and security in the DRC, but found a direct and material connection.⁷⁹ The court noted that the Supreme Court has found speech restrictions to be justified through connections based on anecdote, history and common sense rather than strictly empirical data.⁸⁰ Furthermore, the court observed that "covered companies have ample opportunity under the Rule to add qualifying comments and explanation to any public disclosure they may be required to make."⁸¹

Thus, the United States District Court for the District of Columbia

⁷¹ *Nat'l Ass'n of Mfrs.*, 956 F. Supp. 2d at 56 (internal citations omitted).

⁷² *Id.* at 61.

⁷³ *Id.*

⁷⁴ *Id.* at 66.

⁷⁵ *Id.* at 68.

⁷⁶ STEPTOE, *supra* note 67.

⁷⁷ *Nat'l Ass'n of Mfrs.*, 956 F. Supp. 2d at 67.

⁷⁸ STEPTOE, *supra* note 67.

⁷⁹ *Id.*

⁸⁰ *Nat'l Ass'n of Mfrs.*, 956 F. Supp. 2d at 78–79.

⁸¹ STEPTOE, *supra* note 67.

denied the Plaintiffs' motion for summary judgment and granted the SEC's motion for summary judgment.⁸² In an appeal of this decision,⁸³ a divided U.S. Court of Appeals for the District of Columbia Circuit ruled that the SEC's rule did violate the First Amendment, but that the SEC did not act arbitrarily or capriciously, and that the cost benefit analysis was adequate.⁸⁴ Thus, the rule is no longer good law, just six weeks before the May 31, 2014 reporting deadline for first disclosures, leaving companies in "limbo" for compliance.⁸⁵

C. *An Overview: Section 1504 Oil Payment Disclosures*

1. *Purpose and Background of Section 1504*

The basic purpose of section 1504 "is to bring greater transparency to extractive-related payments made to governments by resource extraction issuers [that are] required to report to the SEC."⁸⁶ With this provision, Congress intended to address the "resource curse" phenomenon in which oil, gas reserves and minerals lead to "corruption, wasteful spending, military adventurism, and instability" in a country when "oil money intended for a nation's poor ends up lining the pockets of the rich or is squandered on showcase projects instead of productive investments."⁸⁷ Initially, the Extractive Industries Transparency Initiative (EITI) was developed to address this same concern.⁸⁸ Under the EITI, participating companies and their host governments "submit payment information confidentially to an independent reconciler who compiles the information and publishes a publicly accessible report."⁸⁹ Much of the success of the EITI was due to the combination of business and government support on a global scale.⁹⁰ However, Congress was unsatisfied with the voluntary

⁸² *Nat'l Ass'n of Mfrs.*, 956 F. Supp. 2d at 82.

⁸³ *Nat'l Ass'n of Mfrs. v. SEC*, 2014 WL 1408274 (D.C.C. Apr. 14, 2014).

⁸⁴ Yin Wilczek, *D.C. Circuit Rules Conflict Minerals Law, SEC Regulation Violate First Amendment* BLOOMBERG LAW (Apr. 15, 2014), available at <http://bloomberglaw.com/exp/eyJpZCI6IkEwRTIBOVk1VDM/anM9MCZzdWJzY3JpcHRpb250eXBIPWJuYXNsZCZpc3N1ZT0yMDE0MDQxNSZjYW1wYWlnbj1ibmFlbWFpbGxpbnsmc2l0ZW5hbWU9Ym5hIiwY3R4dCI6IkJCTkEiLCJ1dWlkljoibjkrSTVSvTFCNHITVU4rWnM1Umt5QT09aVFKdFivRUIJVVVtMStNcJg0WnRKdz09IiwidGltZSI6IjEzOTc1MjAwMjcwMzMlLCJzaWciOiIyT2lhcXYyS0gzWnVSTExXcFBdTFRyRlE3Nk09Iiwidil6IjEifQ==>

⁸⁵ *Id.*

⁸⁶ Letter from Benjamin L. Cardin, U.S. Senator, to Mary L. Shapiro, Chairman, Sec. & Exch. Comm'n (Dec. 1, 2010).

⁸⁷ *Am. Petroleum Inst. v. SEC*, 953 F. Supp. 2d 5, 8 (D.D.C. 2013) (citing 156 CONG. REC. S3816 (May 17, 2010) (statement of Sen. Lugar)).

⁸⁸ *Id.* at 9.

⁸⁹ *Id.*

⁹⁰ GRANT D. ALDONAS, ANALYSIS OF SECTION 1504 OF THE WALL STREET REFORM AND CONSUMER PROTECTION ACT, SPLIT ROCK INT'L, INC. 5 (2011).

international initiative and sought instead to apply this standard to all resource extraction issuers.⁹¹

2. Requirements of Section 1504

Section 1504 of the Dodd-Frank Act, titled “Disclosure of Payments by Resource Extraction Issuers,” requires the Commission to “issue final rules that require each resource extraction issuer to include in an annual report of the resource extraction issuer information relating to any payment made by the resource extraction issuer,” its subsidiaries or other entities under its control to “a foreign government or the Federal Government for the purpose of the commercial development of oil, natural gas, or minerals.”⁹² A resource extraction issuer is defined as a company that “(i) is required to file an annual report with the Commission; and (ii) engages in the commercial development of oil, natural gas, or minerals.”⁹³ The report should include “(i) the type and total amount of such payments made for each project of the resource extraction issuer relating to the commercial development of oil, natural gas, or minerals; and (ii) the type . . . made to each government.”⁹⁴ Additionally, “[t]o the extent practicable,” the SEC should publish online a “compilation of the information required to be submitted.”⁹⁵

Based on this language, the SEC promulgated a final rule; “except for where the language or approach of Section 13(q) clearly deviates from the EITI, the final rules are consistent with the EITI.”⁹⁶ The final rule requires that issuers provide annual reports with disclosures made through a new form, Form SD, rather than the existing Exchange Act annual report.⁹⁷ Additionally, the Commission requires public filing of the annual reports and Form SD through its online EDGAR system.⁹⁸ With this interactive electronic data, the rule requires the use of electronic tags that identify:

- The total amounts of the payments by category;
- The currency used to make the payments;
- The financial period in which the payments were made;
- The business segment of the resource extraction issuer that made the payments;

⁹¹ *Am. Petroleum Inst.*, 953 F. Supp. 2d at 9.

⁹² 15 U.S.C. § 78m(q)(2)(A) (2012).

⁹³ *Id.* § 78m(q)(1)(D).

⁹⁴ *Id.* § 78m(q)(2)(A).

⁹⁵ *Id.* § 78m(q)(3)(A).

⁹⁶ Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56,365, 56,367 (Sept. 12, 2012) (to be codified at 17 C.F.R. pts. 240, 249).

⁹⁷ *Id.* at 56,368.

⁹⁸ *Id.*

- The government that received the payments and the country in which the government is located; and
- The project of the resource extraction issuer to which the payments relate.⁹⁹

The final rules mandate that this information be disclosed publicly.¹⁰⁰ In this instance, it does deviate from the EITI, which does not require public disclosure of payments by individual companies or for individual projects.¹⁰¹ The final rules provide no exemptions, not even for small businesses, despite small business exemptions located in other provisions of Dodd-Frank.¹⁰²

3. American Petroleum Institute v. SEC

In response to this rulemaking, the American Petroleum Institute, the U.S. Chamber of Commerce, the Independent Petroleum Association of America and the National Foreign Trade Council filed a complaint in the United States District Court for the District of Columbia.¹⁰³ The court allowed Oxfam America, Inc. to intervene as a defendant.¹⁰⁴ “Plaintiffs argued that section 13(q) and the Rule compel speech in violation of the First Amendment” and present several APA challenges.¹⁰⁵ The court declined to reach the First Amendment issues because there were two substantial errors: “the Commission misread the statute to mandate public disclosure of the reports” and the Commission’s “decision to deny any exemption was, given the limited explanation provided, arbitrary and capricious.”¹⁰⁶

The court held that Section 13(q) of the Exchange Act did not require that disclosure of the annual resource extraction payments reports be made publically.¹⁰⁷

The court made clear that “while the statute referred to a public *compilation* of the resource extraction payments information required to be submitted, this directive was limited ‘to the extent practicable’ and did not address whether or not the resource extraction payments reports must be

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ ALDONAS, *supra* note 90, at 6.

¹⁰² Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg., 56,365, 56,372 (Sept. 12, 2012) (to be codified at 17 C.F.R. pts. 240, 249).

¹⁰³ See generally *Am. Petroleum Inst. v. SEC*, 953 F. Supp. 2d 5 (D.D.C. Jul. 2, 2013).

¹⁰⁴ *Id.* at 11.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.* (emphasis in original).

¹⁰⁷ LAURA D. RICHMAN ET AL., MAYER BROWN, US DISTRICT COURT VACATES THE SEC’S RESOURCE EXTRACTION PAYMENTS DISCLOSURE RULE 1 (July 8, 2013).

made public.”¹⁰⁸ Furthermore, the court stated that the compilation aspect was deliberate to allow “the SEC to selectively omit public disclosures of commercially sensitive information.”¹⁰⁹ Because the SEC relied on the “unjustified assumption that it was Congress’s judgment” that full public disclosure was required, rather than conducting its own analysis, the court held that the SEC’s rule was invalid.¹¹⁰

In determining that the Commission erred, the court focused on the lack of disclosure exemptions for “resource extraction payments made in countries such as Angola, Cameroon, China and Qatar, where such disclosure is prohibited.”¹¹¹ “[T]he SEC argued that adopting an exemption would have been ‘inconsistent’ with the ‘structure and language of Section 13(q).’”¹¹² The court, however, found that “the SEC ‘impermissibly rested on the blanket proposition that avoiding all exemptions best furthers section 13(q)’s purpose.”¹¹³

The court found that the SEC misread the phrases “a compilation of the information” and “[t]o the extent practicable” and explained that a natural reading would suggest an exemption for commercially sensitive information.¹¹⁴ “According to the court, the SEC focused on a broad and incorrect reading of the statute’s purpose rather than undertaking specific analysis and in so doing ‘abdicated its statutory responsibility to investors.’”¹¹⁵

Thus, the United States District Court for the District of Columbia granted the motion to vacate the rule and remanded to the SEC for further proceedings.¹¹⁶ The SEC declined to appeal.¹¹⁷ In response to the court’s decision, SEC Commissioner Daniel Gallagher said rewriting the rule “should be very low on our to-do list” because the SEC has little expertise where foreign policy and energy policy are concerned.¹¹⁸

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.* at 2.

¹¹² *Id.*

¹¹³ *Id.*

¹¹⁴ *Am. Petroleum Inst. v. SEC*, 953 F. Supp. 2d 5, 14–15 (D.D.C. Jul. 2, 2013).

¹¹⁵ *RICHMAN ET AL.*, *supra* note 107, at 2.

¹¹⁶ *Am. Petroleum Inst.*, 953 F. Supp. 2d at 8.

¹¹⁷ Samuel Rubinfeld, *SEC Declines to Appeal Extractive Disclosure Ruling*, WALL ST. J. (Sept. 3, 2013, 3:33 PM), <http://www.blogs.wsj.com/riskandcompliance/2013/09/03/sec-declines-to-appeal-extractive-disclosure-ruling/html>.

¹¹⁸ Daniel M. Gallagher, Comm’r, Sec. & Exch. Comm’n, Statement at AICPA/SIFMA Financial Management Society Conference on the Securities Industry (Oct. 25, 2013).

III. EFFECTS: THE COST OF BEING COVERED

A. *The Effects of Section 1502*

1. *Costs and Benefits of Compliance*

While the U.S. Court of Appeals for the District of Columbia overturned the SEC's final rule because it compelled speech in violation of the First Amendment, as detailed above that is only a small part of the rule, and the rest is likely to remain intact. The SEC's rulemaking process exposed the certain costs and uncertain benefits of the section 1502 conflict minerals provision. The SEC notes that the objectives of Section 1502 do not appear to be those that will "necessarily generate measurable, direct economic benefits to investors or issuers."¹¹⁹ However, some commentators emphasize that "sustainable and responsible investors" may be interested in assessing the risk that a company's supply chain contains these minerals.¹²⁰

The commentators explained during rulemaking that "warring parties [in the DRC] finance themselves via control of mines," and in so doing, these parties "subject[] the civilian population to [atrocities such as] massacres, rape, extortion, forced labour and recruitment of child soldiers."¹²¹ These conflict minerals then join the global supply chain.¹²² Due diligence is thought by some policy makers to be the most effective means of tackling the conflict minerals trade because it is a concept that manufacturers understand and can implement, according to these policy makers, immediately and at low cost.¹²³

This cost however, some commentators argue, is not warranted because the proposed rule did not adequately demonstrate any benefits to investors.¹²⁴ These commentators "focused on three categories of costs as the most significant: [d]ue diligence for both suppliers and issuers, information technology ('IT') costs, and audit costs."¹²⁵ The SEC recognizes that the final rule will impose significant compliance costs on companies who use or supply conflict minerals and notes that most of the commentators believed that compliance costs would be high.¹²⁶ However, the cost in merely determining whether conflict minerals are used in a supply chain may be high in themselves; for instance, gold with high levels

¹¹⁹ Conflict Minerals, 77 Fed. Reg. 56,274, 56,335 (Sept. 12, 2012) (to be codified at 17 C.F.R. pts. 240, 249b).

¹²⁰ *Id.* at 53,336.

¹²¹ Letter from Corinna Gilfillan, Head of U.S. Off. Global Witness to Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n (Oct. 12, 2010) (on file with the SEC).

¹²² *Id.*

¹²³ *Id.*

¹²⁴ 77 Fed. Reg. at 56,335.

¹²⁵ *Id.* at 56,336.

¹²⁶ *Id.* at 56,279.

of purity, bought through many sources, would have no identifying features with which to readily trace the origin.¹²⁷ Moreover, most manufacturers have tens if not hundreds of suppliers, all of which would need to be traced.¹²⁸ In a “complex, multi-layered network of trading companies and suppliers,” most of these companies only have contact with the first tier supplier.¹²⁹

Additionally, “cost per unit of manufactured product for those items for which one or more conflict minerals are necessary may vary widely from pennies a part . . . to possibly many thousands of dollars per finished manufactured product.”¹³⁰ The high cost per product ratio could be especially burdensome for small and startup companies, who produce far fewer products than their larger counterparts.¹³¹ A study commissioned by Senator Durbin, a proponent of the bill, found that the bulk of the cost of compliance would fall on “suppliers to public companies, including small and medium-sized businesses.”¹³² These small businesses face higher compliance costs in order to determine and verify sources of minerals—costs relating to hiring additional staff, auditing companies, lawyers, accountants and buying software for data management.¹³³ Because of these costs, small businesses may be unable to comply due to lack of resources to trace minerals to the point of extraction, putting both themselves and their SEC regulated clients in a precarious situation.¹³⁴

Overall, the monetary range for costs of compliance with section 1502 provided by commentators was anywhere between \$387,650,000 and \$16 billion.¹³⁵ Using a combination of these analyses, the Commission concluded the estimated initial cost of compliance to be between

¹²⁷ Letter from Patrick Dorsey, Senior Vice President, Sec’y and General Counsel, Tiffany & Co., to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n (Sept. 29, 2010) (on file with the SEC).

¹²⁸ Letter from Nat’l Ass’n of Mfrs. to Mary L. Schapiro, Chairman, Sec. & Exch. Comm’n (on file with the SEC).

¹²⁹ *Id.*

¹³⁰ Letter from Robert W. Row to Elizabeth M. Murphy, Sec’y, Sec. & Exch. Comm’n (Oct. 29, 2010) (on file with the SEC) (stating that “an Intel spokesperson is reported in the Columbus Dispatch 25 July 2010 to have estimated”).

¹³¹ *Id.*

¹³² Memorandum from Fin. Serv. Comm. Majority Comm. Staff to Members of the Comm. on Fin. Servs. 3 (May 16, 2013) (on file with the U.S. House of Representatives Comm. on Fin. Servs.).

¹³³ *The Costs and Consequences of Dodd-Frank Section 1502: Impacts on America and the Congo: Hearing Before the Subcomm. on Int’l Monetary Pol’y & Trade of the Comm. on Fin. Serv.,* 112 Cong. 2, 25 (2012) (statement of Steve Pudles, CEO of Spectral Response).

¹³⁴ Letter from Olympia Snowe, U.S. Senator, to Mary L. Schapiro, Chairman, Sec. & Exch. Comm’n (Nov. 17, 2011) [hereinafter Letter from Snowe] (on file with the SEC).

¹³⁵ Conflict Minerals, 77 Fed. Reg. 56,274, 56,336 (Sept. 12, 2012) (to be codified at 17 C.F.R. pts. 240, 249b).

approximately \$3 billion to \$4 billion, with the annual cost of ongoing compliance between \$207 million and \$609 million.¹³⁶ The National Association of Manufacturers, however, estimates that the compliance costs will be between \$8 billion and \$16 billion.¹³⁷ Whatever the exact number, the monetary costs are high and hard to weigh against the non-quantifiable benefits of section 1502.

2. *Scope of Section 1502*

Section 1502 has a wide reaching scope that could affect far more businesses than was likely intended. This section applies to persons who are required to file reports with the Commission and who have products in which “conflict minerals are necessary to the functionality or production of a product manufactured by such person.”¹³⁸ Conflict minerals are considered necessary based on a broad definition not limited to the product's basic function or economic utility.¹³⁹ If there are multiple functions or uses for the conflict minerals, they “need only be necessary for one function to be ‘necessary to the functionality’ of that product.”¹⁴⁰ Even if the use of conflict minerals is “purely ornamental, that may not be sufficient to exclude product from the rule if the product itself is primarily ornamental.”¹⁴¹ The National Association of Manufacturers believes nearly every manufacturing sector will be affected by the legislation and regulations, from electronics to “automotives, medical devices, consumer products, defense, capital goods, [and] aerospace.”¹⁴²

The SEC's rule for conflict minerals “applies to all issuers that file reports with the Commission under Exchange Act Sections 13(a) or 15(d), whether or not the issuer is required to file such reports,” including voluntary filers.¹⁴³ This includes “domestic companies, foreign private issuers, and smaller reporting companies.”¹⁴⁴ But while “the provision only applies to the SEC-listed companies, the truth is it will affect non-SEC companies and small businesses all over this country,” that are members of

¹³⁶ *Id.* at 56,334.

¹³⁷ *Id.* at 56,336.

¹³⁸ 15 U.S.C. §§ 78m(p)(2)(A)–(B) (2012).

¹³⁹ SQUIRE SANDERS LLP, SUMMARY OF CONFLICT MINERALS RULE 5 (2012).

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² See Letter from Nat'l Ass'n of Mfrs. to Mary L. Schapiro, Chairman, Sec. & Exch. Comm'n (on file with the SEC).

¹⁴³ *Dodd-Frank Wall Street Reform Act Frequently Asked Questions: Conflict Materials*, SEC (Apr. 7, 2014),

<http://www.sec.gov/divisions/corpfin/guidance/conflictminerals-faq.htm>.

¹⁴⁴ Conflict Minerals, 77 Fed. Reg. 56,274, 56,285 (Sept. 12, 2012) (to be codified at 17 C.F.R. pts. 240, 249b).

the supply chain for these SEC regulated companies.¹⁴⁵ Because these SEC regulated companies are required to trace the origin of conflict minerals through their supply chain, any business within that chain, including small, private businesses, will need to participate in the potentially costly due diligence process.

Members of the Senate and House Small Business Committees were concerned that the SEC's initial analysis of the costs of the proposed rule did not accurately consider the proposed rule's impact on small businesses.¹⁴⁶ These members were concerned that the SEC did not consider all compliance costs throughout the supply chain for these small businesses or the fact that small businesses would not have the resources to fully trace back the origins of their products.¹⁴⁷ These Senators urged the SEC to consider adding a *de minimis* standard to the regulation, exempting products that contain less than a set amount of conflict minerals from the regulation, and to create an "indeterminate origin" category within the rule to allow for a more lenient standard for compliance if small businesses are unable to determine the origin of the minerals.¹⁴⁸ In its final rule however, the SEC did not create any exemptions for small businesses nor did it exempt the *de minimis* use of conflict minerals.¹⁴⁹

Despite the concern expressed by many commentators, in its final rule, the SEC decided not to exempt smaller reporting companies under the belief that it would not achieve Congress's objectives with regards to section 13(p). Thus, the statutory section applies to all issuers with necessary conflict minerals regardless of size and regardless of placement in the supply chain.¹⁵⁰ However, the SEC did include an extra two-year temporary period for small reporting companies to use the "DRC conflict undeterminable" label, in recognition that smaller companies may face disproportionally higher burdens than larger companies, and in hopes that a longer temporary period may alleviate some of those burdens.¹⁵¹ It is unclear, however, whether this longer temporary period for small reporting companies will be beneficial, given that larger reporting companies may rely on these small companies in their supply chain to determine the origin of their minerals by the larger companies' shorter deadlines. Larger SEC reporting companies may end up exerting pressure on these smaller reporting companies, as well as small private businesses that are not

¹⁴⁵ *The Costs and Consequences of Dodd-Frank Section 1502: Impacts on America and the Congo: Hearing Before the Subcomm. on Int'l Monetary Policy & Trade of the Comm. on Fin. Serv., supra* note 133, at 10.

¹⁴⁶ See Letter from Snowe, *supra* note 134.

¹⁴⁷ *Id.*

¹⁴⁸ *Id.*

¹⁴⁹ See generally 77 Fed. Reg. at 56,274.

¹⁵⁰ *Id.* at 56,361.

¹⁵¹ *Id.* at 56,281.

required to report, in order to obtain necessary data to make themselves compliant.¹⁵²

The SEC approximates that roughly “6,000 issuers [almost half of the U.S. companies already subject to SEC regulation] will be directly impacted by the rule and that many private companies [including small businesses] in the supply chains of these issuers will be impacted indirectly.”¹⁵³ These indirectly impacted issuers include small businesses. Additionally, “[t]he SEC has estimated that 75% percent of registrants subject to Section 1502 will need to develop a Conflict Minerals Report and have it audited by an independent third party.”¹⁵⁴ While these numbers are certainly accurate estimates, the actual number of affected businesses could be far higher.

B. *The Effects of Section 1504*

1. *Costs and Benefits of Compliance*

Although the SEC is in the process of rewriting the rule for section 1504 to conform with the district court’s decision in *American Petroleum Institute v. SEC*, the rulemaking process for the original rule provides an indication of the SEC’s perspective and suggests what the new rule might look like. Based on the original analysis, the costs of this rule may be high both monetarily and in terms of decreased U.S. competition in the global oil market. The SEC recognized that its original final rule for section 1504 would “impose a burden on competition,” but believed that “any burden on competition that may result [is] necessary in furtherance of the purposes of the Exchange Act, including Section 13(q).”¹⁵⁵ The SEC admitted the benefits of the rule “do not appear to be ones that will necessarily generate measurable, direct economic benefits to investors or issuers,” but rather relate to accountability, stability and good governance in resource-rich countries around the world.¹⁵⁶ Additionally, possible benefits might include help to investors in assessing the risks faced by resource extraction issuers that operate in these resource-rich countries, as well as the individual project level risks.¹⁵⁷

By contrast, commentators anticipated the costs to include modifications to the issuer’s resource planning and financial reporting systems in order to capture the new information that must be reported, as

¹⁵² See *Conflict Minerals: Frequently Asked Questions*, *supra* note 61.

¹⁵³ ERNST & YOUNG, *supra* note 47, at 1.

¹⁵⁴ *Id.* at 6.

¹⁵⁵ Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56,365, 56,372 n.88 (Sept. 12, 2012) (to be codified at 17 C.F.R. pts. 240, 249).

¹⁵⁶ *Id.* at 56,398.

¹⁵⁷ *Id.* at 56,408.

well as the additional time and people required for ongoing compliance.¹⁵⁸ However, the commentators disputed the extent of the effect of this cost. The SEC expected that the rule could result in significant economic effects and that issuers with a reporting requirement “could be put at a competitive disadvantage with respect to private companies and foreign companies that are not subject to the reporting requirements.”¹⁵⁹

Monetarily, the SEC’s own estimation was that the original rule would cost U.S. issuers about one billion dollars in initial compliance cost and ongoing compliance costs between \$200 million and \$400 million annually.¹⁶⁰ If correct, “[t]hese estimates would make Section 1504 one of the most costly rules in history and it only applies to one industrial sector.”¹⁶¹ SEC Commissioner Gallagher noted that “[t]he costs this rule will impose are clear enough. Its intended benefits, by contrast, are socio-political and aspirational in nature, worthy but indeterminate — although they are presumed to justify all costs.”¹⁶² Gallagher additionally expressed, “even if I had no objection in principle to efforts to achieve social and foreign policy objectives through the disclosure requirements of the securities laws, I am not able to support this rule today, because the analysis is incomplete.”¹⁶³

2. *Scope of Section 1504*

While this rule affects only one industrial sector, it affects small and large entities alike. A company is considered a “resource extraction issuer,” and thus covered by the original rule, if it “is required to file an annual reports with the Commission; and engages in the commercial development of oil, natural gas, or minerals.”¹⁶⁴ Commercial development includes “exploration, extraction, processing, and export, or the acquisition of a license for any such activity.”¹⁶⁵ This involves “companies that drill for oil, mine for precious metals or minerals or extract natural gas.”¹⁶⁶ While

¹⁵⁸ *Id.* at 56,404.

¹⁵⁹ *Id.* at 56,402.

¹⁶⁰ *Id.* at 56,411.

¹⁶¹ Brigham A. McCown, *Oil and Gas Payment Disclosure May Harm Investors*, FORBES (Mar. 22, 2013, 10:27 AM), <http://www.forbes.com/sites/brighammccown/2013/03/22/oil-and-gas-payment-disclosure-may-harm-investors/>.

¹⁶² Gallagher, *supra* note 31.

¹⁶³ *Id.*

¹⁶⁴ *Disclosure of Payments by Resource Extraction Issuers: A Small Entity Compliance Guide*, SEC (Nov. 9, 2012), <http://www.sec.gov/info/smallbus/secg/resource-extraction-small-entity-compliance-guide.htm>.

¹⁶⁵ *Id.*

¹⁶⁶ PRICEWATERHOUSECOOPERS, *ANOTHER SIDE OF DODD-FRANK: UNDERSTANDING SECTION 1504 2* (2012).

companies engaged directly in any aspect of these activities are covered, the definition is not meant to include “activities that are ancillary or preparatory to commercial development.”¹⁶⁷

Section 1504 requires resource extraction issuers to report any payments made to governments (foreign or the U.S.) for the purpose of commercial development of oil, natural gas or minerals that are not *de minimis*, which the SEC has defined as “any payment or series of payments aggregating \$100,000 or more during an issuer’s fiscal year.”¹⁶⁸ Essentially, “all payments to governments . . . must be tracked, regardless of the value or materiality of any individual payment.”¹⁶⁹

According to the SEC over 1,100 companies will be covered by the information disclosure requirements under Section 1504, including a majority of the most profitable international oil companies (e.g. Chevron, Exxon, BP, Shell and Total), the largest global mining companies (Rio Tinto, Vale and BHP Billiton) and certain state-owned entities (Petrobras, Sinopec and Petrochina).¹⁷⁰

However, many state-owned oil companies, some of the largest oil companies in the world, in countries such as Russia, China, Iran and Venezuela do not operate in the highly transparent, intensely regulated world of U.S. issuers.¹⁷¹ In fact, the ten largest oil companies in the world are national oil companies that are not listed on stock exchanges.¹⁷² If the largest companies in the world are unaffected, it will be difficult to reduce the “resource curse” phenomenon to any great extent.¹⁷³ According to SEC Commissioner Gallagher, these foreign companies “will reap competitive advantage through today’s rules.”¹⁷⁴

Furthermore, the final rules for section 1504 do not offer

¹⁶⁷ *Disclosure of Payments by Resource Extraction Issuers: A Small Entity Compliance Guide*, *supra* note 164.

¹⁶⁸ *Conflict Minerals: Frequently Asked Questions*, *supra* note 61, at 3.

¹⁶⁹ *Id.*

¹⁷⁰ *Q&A: Company Disclosures Under Dodd-Frank Section 1504*, REVENUE WATCH INST. (Aug. 27, 2012), <http://www.renewatch.org/news/qa-company-disclosures-under-dodd-frank-section-1504>.

¹⁷¹ Gallagher, *supra* note 31.

¹⁷² ALDONAS, *supra* note 90, at 12.

¹⁷³ *Id.* at 13 n.35 (defining “resource curse” as “an increasingly perverse development pattern rooted in the interaction between oil, gas mineral dependence and weak states . . . inextricably intertwined with the lack of transparency in the extractive industries”) (citation omitted).

¹⁷⁴ Gallagher, *supra* note 31.

exemptions of any kind.¹⁷⁵ The Commission declined to exercise its exempted authority to waive the disclosure requirements for four countries whose laws do not allow this type of disclosure: Angola, Cameroon, China and Qatar.¹⁷⁶ The Commission acknowledged that the commentators' concerns seemed warranted, but it believed that "adopting such an exemption would be inconsistent with the structure and language of Section 13(q)."¹⁷⁷ Additionally, the original final rule did not provide an exemption for instances when an issuer has a confidentiality provision in an existing or future contract or for commercially sensitive information.¹⁷⁸

Due to the lack of exemptions, the original final rule also affects small entities that are required to file an annual report with the Commission under sections 13(a) or 15(d) of the Exchange Act and that are engaged in the commercial development of oil, natural gas or minerals, regardless of the size of the company.¹⁷⁹ The SEC did not believe an exemption would be consistent with the statutory purpose of Section 13(q) because "different disclosure requirements . . . for small entities . . . would impede the transparency and comparability of the disclosure."¹⁸⁰ This lack of exemptions could be repeated in the final rule, or changed, now that the SEC knows that it has discretion in determining the scope of disclosure.

3. *Other Effects of Section 1504*

Because the rule for section 1504 has been vacated, there is uncertainty for businesses as to the future of the requirement. By vacating the SEC rule for oil payment disclosure, it is effectively removed from the Federal Register.¹⁸¹ As such, "at the present time, there is no requirement to file a Form SD to report resource extraction payments."¹⁸² However, issuers that were impacted by the SEC's resource extraction payments disclosure rule are advised to continue to monitor developments in the new 1504 rulemaking and related litigation for further developments, as the Dodd-Frank mandate of payment reporting remains intact.¹⁸³ The uncertainty presented by the vacated rule creates challenges in preparing for reporting

¹⁷⁵ Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. 56,365, 56,368 (Sept. 12, 2012) (to be codified at 17 C.F.R. pts. 240, 249).

¹⁷⁶ *Id.* at 56,371.

¹⁷⁷ *Id.* at 56,372.

¹⁷⁸ *Id.* at 56,371.

¹⁷⁹ *Id.* at 56,417; *Disclosure of Payments by Resource Extraction Issuers: A Small Entity Compliance Guide*, *supra* note 164.

¹⁸⁰ Disclosure of Payments by Resource Extraction Issuers, 77 Fed. Reg. at 56,417.

¹⁸¹ RICHMAN ET AL., *supra* note 107, at 2.

¹⁸² *Id.*

¹⁸³ See SAMUEL W. COOPER & S. JOY DOWDLE, PAUL HASTINGS LLP, FEDERAL COURT VACATES THE SEC'S SECTION 1504 REPORTING REQUIREMENTS FOR PAYMENTS TO GOVERNMENTS BY OIL, GAS, AND MINING COMPANIES (2013).

and companies will face difficulties in preparing for the unknown. It will likely be some time before businesses will know what the final rule for the reporting requirement will be; the SEC will need to publish a proposed rule, allow interested parties to comment and then approve the rule.¹⁸⁴ This process may translate into monetary costs for affected businesses as they direct time and human resources into compliance preparations. These ancillary costs of unguided preparations could further harm businesses beyond the original cost of the rule.

IV. PROPOSAL

Dodd-Frank was emergency legislation to correct problems on Wall Street and to protect consumers. Provisions 1502 and 1504 do neither of those things. Moreover, both provisions seek attenuated and intangible goals at high practical costs. Ironically, these economically unsound provisions were included in a bill meant to stabilize and protect the economy. Now that it has been nearly four years since Dodd-Frank, and in light of the problems that have arisen with these provisions, it is time for Congress to reexamine these two provisions. Congress needs to reconsider the relationship between the humanitarian purpose of the provisions and the goals of Dodd-Frank and whether this legislation is the best way to accomplish those humanitarian goals. Congress should reexamine the language of the bill and, if not repeal, amend the two provisions to better address the economic issues that have been encountered. If Congress is unable to do this, the SEC should use its rulemaking power to interpret the provisions in a way that minimizes the strain to small businesses as well as to investors and the overall market. Finally, if the government does not act to remedy these concerns, businesses and their representative associations should challenge the provisions through continuing legal efforts and lobbying.

A. *Congress Should Reconsider and Rewrite the Provisions*

Congress did not fully explore the implications of sections 1502 or 1504 before Dodd-Frank was passed.¹⁸⁵ Thus, it would be beneficial for Congress to take the opportunity to go back and reexamine these provisions in light of the difficulties exposed by the SEC rulemaking. It is clear that both sections 1502 and 1504 will have substantial and wide-reaching

¹⁸⁴ RICHMAN ET AL., *supra* note 107, at 2.

¹⁸⁵ See Letter from Mike Koehler, Assistant Professor of Bus. Law, Butler Univ., to Sec. & Exch. Comm'n (Sept. 3, 2010) [hereinafter Koehler] (on file with the SEC); see also Letter from David M. Sindelar, CEO, Viasystems, to Mary Schapiro, Chairman, Sec. & Exch. Comm'n (Aug. 9, 2012) [hereinafter Sindelar] (on file with the SEC).

effects. Congress needs to reexamine these provisions to determine if they will accomplish their humanitarian goals through these types of disclosures and if the price of these disclosures comes at a cost Congress is willing to bear. Additionally, Congress needs to examine whether the SEC is the proper outlet for promoting its humanitarian goals.

In light of the seemingly opposite conclusions in the legal challenges on sections 1502 and 1504, Congress should weigh in on its intentions and perhaps amend section 1502 to address the concerns in interpretation raised by the plaintiffs in *National Ass'n of Manufacturers v. SEC*. The district court in that case determined that the lack of exceptions was the "product of reasoned decision-making" and that the SEC's conclusion that exceptions "would jeopardize the effectiveness of the Rule" was permissible.¹⁸⁶ By contrast, the court in *American Petroleum Institute v. SEC* determined the lack of exemptions in the rule for section 1504 was arbitrary and capricious, and that the SEC was incorrect in resting "on the blanket proposition that avoiding all exemptions best furthers section 13(q)'s purpose."¹⁸⁷ These differing decisions involving similar provisions and similar rulemaking reflect unclear congressional intent, and Congress is in a better position than both the court systems and the SEC to express what in fact it intended.

Accordingly, because section 1502 was silent as to the availability of a *de minimis* exception, Congress should weigh in on whether it now believes a *de minimis* exception is appropriate or whether it did and does intend to rely on the SEC's deference. Congress should also expound upon the requirements for small businesses, specifically whether it intended that no exceptions for small businesses were to be given under section 1502 or whether it believes the purposes of the Act can be achieved with exceptions for small businesses. Congress should also weigh in on whether the requirements in Exchange Act sections 3(f) and 23(a)(2) were meant to apply to section 1502 or whether the lack of reference was purposeful. These sections are meant to "promote efficiency, competition, and capital formation" and to avoid imposing "a burden on competition not necessary or appropriate in furtherance of the purposes of" the Exchange Act.¹⁸⁸ If applicable, the SEC rulemaking is surely flawed, particularly in respect to small businesses, which would be unfairly burdened due to fewer resources with which to fully trace back the origins of their products.

Additionally, for section 1502, Congress could encourage other countries to participate in a joint effort rather than unilaterally implementing a regulatory scheme that injures U.S. businesses to the

¹⁸⁶ *Nat'l Ass'n of Mfrs. v. SEC*, 956 F. Supp. 2d 43, 66–68 (D.D.C. 2013); STEPTOE, *supra* note 67.

¹⁸⁷ *Am. Petroleum Inst. v. SEC*, 953 F. Supp. 2d 5, 22 (D.D.C. 2013).

¹⁸⁸ 15 U.S.C. §§ 78c(f), 78(w)(a)(2) (2012).

benefit of competitors, such as with the Kimberley Process Certification Scheme (KPCS).¹⁸⁹ The KPCS is an international governmental certification scheme that was set up to prevent trade in diamonds that fund conflict.¹⁹⁰ The KPCS was “endorsed by the United Nations General Assembly (UNGA) and the United Nations Security Council (UNSC) and launched in January 2003.”¹⁹¹ It is an import-export certification scheme that requires participating governments, including the United States, to verify “the origin of rough diamonds, and put in place effective controls to prevent conflict stones from entering the supply chain.”¹⁹² Participant countries pass legislation to implement their part in the scheme domestically, and then can only trade rough diamonds with other members, which creates a strong incentive for additional countries to join.¹⁹³ Congress could better achieve its humanitarian goals, with a diminished competitive cost to U.S. businesses, through a collaborative effort like the KPCS.

From a broader perspective, Congress should explore whether section 1502 would even “help end the conflict in the DRC, and what its effects would be on the Congolese people.”¹⁹⁴ On May 9, 2012, the United States House Financial Services Committee Subcommittee on International Monetary Policy and Trade held a hearing entitled “Costs and Consequences of Dodd-Frank Section 1502: Impacts on America and the Congo” in which both Republican and Democratic members of Congress expressed concern that section 1502 may result in a *de facto* embargo on minerals mined in the Congo, leaving many legitimate miners without means to provide for their families.¹⁹⁵ Additionally, on May 21, 2013, the United States House Financial Services Subcommittee on Monetary Policy and Trade held a hearing on “The Unintended Consequences of Dodd-Frank’s Conflict Minerals Provision” to explore concerns that section 1502 would not reduce conflict in the DRC.¹⁹⁶ It is clear that at least some Congress members are aware of the concerns; it is also clear that Congress needs to discuss in depth whether the uncertain outcome of section 1502 justifies the high costs.

¹⁸⁹ See Woody, *supra* note 33, at 1347–48.

¹⁹⁰ *The Kimberley Process*, GLOBAL WITNESS, <http://www.globalwitness.org/campaigns/conflict/conflict-diamonds/kimberley-process> (last visited Apr. 16, 2014).

¹⁹¹ *Id.*

¹⁹² *Id.*

¹⁹³ *Id.*

¹⁹⁴ See Sindelar, *supra* note 183.

¹⁹⁵ *Id.*

¹⁹⁶ See *The Unintended Consequences of Dodd-Frank’s Conflict Minerals Provision: Hearing Before the Subcomm. on Monetary Pol’y & Trade of the H. Comm. on Fin. Servs.*, 113th Cong. 1 (2013).

Similarly, Congress should reexamine section 1504 with respect to small businesses. Luckily, due to the decision in *American Petroleum Institute v. SEC*, the SEC may be able to interpret section 1504 in a way that is less burdensome for businesses overall. However, as discussed below, the court decision may allow for a much more narrow interpretation, which may require congressional intervention to correct. Congress should make clear its intentions on exceptions, or lack thereof, for conflict of laws for countries such as Angola, Cameroon, China and Qatar and explain whether it believes avoiding all exemptions best furthers section 13(q)'s purpose. Congress should also clearly define "to the extent practicable" and address whether the resource extraction payments reports must be made public. In determining these issues Congress should have purposeful debate with input from relevant parties. Additionally, Congress should explore measures more in line with the existing EITI polices, which have already been proven successful. Congress can accomplish these fixes through committee discussion and, if possible, an amendment to the original provisions in Dodd-Frank.

Moreover, Congress needs to examine whether the SEC is the best agency for accomplishing the provisions' goals. These provisions represent an "unprecedented use of U.S. securities regulation as an instrument of human rights policy."¹⁹⁷ The SEC itself has made it clear that these provisions provide few, if any, benefits to investors and that it is not a priority for the agency.¹⁹⁸ Congress should reallocate responsibility for the rulemaking and enforcement of these provisions to an agency more familiar with world issues and better-suited for addressing humanitarian and diplomatic goals, such as the Department of State or the Office of Foreign Assets Control (OFAC) of the Treasury Department, which already handles existing sanctions programs.¹⁹⁹

As a larger lesson, Congress should exercise greater restraint in including riders in bills, especially in legislation that is hurried through Congress. These provisions were inserted into Dodd-Frank at the last minute and thus were not subjected to any meaningful debate or analysis prior to enactment.²⁰⁰ In situations in which this has occurred, Congress should make it a routine practice to review riders after enactment to make sure the unrelated provisions are not impracticable or irresponsible.

¹⁹⁷ Memorandum from FSC Majority Comm. Staff to Members of the Comm. on Fin. Serv. 3 (May 16, 2013) (on file with the House of Representatives Committee on Financial Services).

¹⁹⁸ See Gallagher, *supra* note 31.

¹⁹⁹ Woody, *supra* note 33, at 1351.

²⁰⁰ Koehler, *supra* note 185.

B. *The SEC Should Reinterpret the Language*

While it is not likely that the SEC will have a chance to fully reinterpret section 1502 after the decision in *National Ass'n of Manufacturers v. SEC*, due to the narrow issue on which it was overturned, further appeals may allow the SEC to revise it with a greater eye to their discretion with regard to small businesses. However, due to the district court's decision in *American Petroleum Institute v. SEC*, the SEC is in a position with section 1504 to reinterpret Congress's mandate with greater discretion.

The American Petroleum Institute (API) recommends the new rule include a "compilation model" in which the data required to be disclosed is compiled rather than disclosed individually.²⁰¹ This model "mitigates the risk that company payment data could be used by competitors to the detriment of SEC-registered resource extraction issuers and their shareholders."²⁰² Additionally, the API advocates for a conflict of laws exemption, consistent with the district court's ruling, in order to prevent the burden on competition posed by this disclosure in countries in which disclosure would violate local laws.²⁰³ By using its authority to interpret section 1504 this way, the SEC better protects investors by protecting the ability of these corporations to do business.

Even if this is not possible, the SEC should at the very least find an interpretation of the language that allows for small entity exemptions. While there are high costs with uncertain benefits placed upon all businesses, small businesses in particular face difficulty in complying with these provisions, putting them at a disadvantage that goes against the small entity language in SEC rulemaking. The SEC should use its authority under the Regulatory Flexibility Act, which allows agencies like the SEC to consider significant alternatives that would accomplish their stated objectives, while minimizing any significant adverse impact on small entities.²⁰⁴

Supporters of section 1504 and the original SEC final rule, however, call for revisions that require disclosure of project-level payments without country-level exemptions, and believe these disclosures should be

²⁰¹ Letter from Patrick T. Mulva, Chairman, Am. Petroleum Inst. Gen. Fin. Comm., & Stephen Comstock, Dir. of Tax & Accounting Policy, API to Elizabeth M. Murphy, Sec'y, Sec. & Exch. Comm'n 2 (Nov. 7, 2013) (on file with the SEC).

²⁰² *Id.*

²⁰³ *Id.* at 7–9.

²⁰⁴ 5 U.S.C. § 601 (2012).

made available to the public.²⁰⁵ These supporters believe that the district court's decision in *American Petroleum Institute v. SEC* allows for these findings because the narrow holding found only that Congress intended for the Commission to use its broad discretion to reasonably interpret what was an ambiguous statutory mandate, rather than the strict mandate that the Commission believed it had been given.²⁰⁶ It is important that the SEC not heed these views because they ignore the underlying issues with the legislation, and rely on a misleading interpretation of the district court's decision.

Moreover, while the SEC rewrites the new final rule it should take this opportunity to explore again Congress's purpose in the Dodd-Frank Act as a whole, particularly ending "too big to fail," protecting the American taxpayer by ending bailouts and protecting consumers from abusive financial services practices. It would seem counterintuitive that in this Act Congress could intend to include small businesses in sections 1502 and 1504 without exceptions, thereby causing them financial hardship and damaging the economy that Dodd-Frank was intended to fix.

C. *Businesses Should Continue to Challenge*

Businesses and their respective associations should keep challenging these provisions both in court and through lobbying. It is through the efforts of organizations such as the American Petroleum Institute, the U.S. Chamber of Commerce, the Independent Petroleum Association of America and the National Foreign Trade Counsel that section 1504 was overturned in favor of better interpretation and analysis.²⁰⁷ Businesses, especially small businesses, need representatives to continue lobbying efforts as the SEC rewrites the rule for section 1504. Simply because the SEC came to the conclusion that it did not have discretion, when in fact the legislature intended to give it deference, does not necessarily mean that the SEC's new rule will fully address the concerns expressed by the plaintiffs in *American Petroleum Institute v. SEC*. With opposing interests committed to an SEC rule that is largely the same as the original, but arrived at through SEC discretion, it is important that a rational cost-benefit analysis prevail.

Because the district and appeals courts upheld many of the more controversial aspects of the SEC rule for section 1502, another appeal

²⁰⁵ See, e.g., Letter from Corinna Gilfillan, Head of the U.S. Office, Global Witness, & Simon Taylor, Dir., Global Witness to Mary Jo White, Chair, Sec. & Exch. Comm'n 1 (Dec. 18, 2013) (on file with the SEC).

²⁰⁶ See, e.g., Letter from Raymond C. Offenheiser et al., President, Oxfam Am., to Mary Jo White, Chair, Sec. & Exch. Comm'n 2 (Sept. 26, 2013) (on file with the SEC).

²⁰⁷ See generally *Am. Petroleum Inst. v. SEC*, 953 F. Supp. 2d 5 (D.D.C. 2013).

would be required to challenge the rule further legally. This requires additional effort from businesses and their associations if they wish to change the SEC's final rule. Alternatively, businesses can lobby Congress to reexamine section 1502, as well as section 1504, in an effort to change or repeal the provision. Finally, because Congress is unlikely to overturn enacted legislation in the current political climate (or even discuss the legislation),²⁰⁸ and in case the SEC chooses a disadvantageous interpretation for the new rule, it is up to the businesses and organizations that are burdened by these provisions to stand up for rational cost benefit analysis.

V. CONCLUSION

Although well intentioned, Dodd-Frank's specialized disclosure provisions 1502 and 1504 do more harm than good overall. Dodd-Frank's lofty goal of financial stability is lost in the socially motivated nature of these sections. Even if sections 1502 and 1504 manage to achieve their purported goals, these benefits are intangible and outweighed by the severe monetary costs and competitive disadvantage to small and large businesses alike. Moreover, this use of the SEC has proven to be a bane to the Commission and set an unfortunate precedent for future legislation. This Note discussed these topics in depth, as well as providing a brief explanation of the financial crisis, Dodd-Frank, the rules for sections 1502 and 1504 and the recent court challenges to those sections. Additionally, this Note explored the costs and benefits of each section. Finally, the Note proposed solutions that could be effectuated by Congress, the SEC or businesses themselves. Hopefully, with diligence by any or all of these parties, there is still time to reform Dodd-Frank in order to protect American businesses and the still recovering economy.

²⁰⁸ See Jonathon Weisman, *Congress Sets Sights Low After 2013 Legislative Record*, GLOBE (Jan. 6, 2014), <http://www.bostonglobe.com/news/politics/2014/01/05/congress-sets-sights-low-after-legislative-record/Hao1MwEGTGQD3qmFLRzc2J/story.html>.

